JAPANESE CAPITALISM IN CRISIS: A REGULATIONIST INTERPRETATION

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Not so long ago, Japan was considered a model that other countries should emulate and learn from. The unique characteristics of the Japanese model of economic development, such as lifetime employment, on-the-job training and intra-firm labour mobility, close involvement of banks in client firm management and strong administrative supervision of the corporate sector by the powerful Ministry of International Trade and Industry (MITI), were believed to be the secrets of success that helped the country to become the second largest economic power in the world from the rubble of the Second World War in only 40 years. For the Japanese people, the 1980s were a proud period when everyone they encountered would express their awe of Japan's achievements, even though, at times, such praise may have been mixed with jealousy or hostility.

What a dramatic change the 1990s have been. Japan has spent the entire decade unable to recover from the bursting of the financial bubble of 1989 and the subsequent financial and economic crisis. Ever-deepening stagnation has led many to conclude that the Japanese model was, in the end, not what it was thought it to be. As the title of the book proclaims, Japanese capitalism is surely in crisis. Are the institutions that characterize the Japanese model archaic and obsolete and should they be replaced by American-style market-based economic institutions, as many analysts seem to argue these days? The book seeks to answer this question.

The principal argument of the authors is that such an interpretation of the recent experience of the Japanese economy is "drastically flawed, as it derives from the use of neo-classical theory as a normative tool". The contributors to the book, by contrast, share the concern for institutional economics and believe that the unprecedented structural crisis in Japan has been generated by the very success of the so-called Japanese model. The authors point to various shortcomings of the conventional analytical framework for understanding the Japanese economy and propose an alternative set of hypotheses, based on regulation theory.

A distinctive feature of regulation theory and other paradigms in the political economy tradition, according to one of the contributors to the book, is "that they try to explain not only the working of the market mechanism but the long-term dynamics of the capitalist economy from a broad social and political perspective". The regulation theory, which was developed for the analysis of American and European long-term history, is extended in this book to interpret the trajectory of the Japanese economy since the Second World War.

This institutional approach to understanding the Japanese economy follows five methodological principles. First, a purely neoclassical description of modern societies as a set of interdependent markets is replaced by the concept of capitalism as a complete institutional system with a sophisticated set of core social relations. In such a framework, markets are no longer the only mechanism for allocating resources. Other mechanisms exist, defining many alternative configurations for economic systems. Secondly, as a consequence of the first principle, the concept of a general equilibrium of interdependent markets is replaced by the analysis of the viability of a given set of structural forms or institutions. The focus is therefore shifted from static to dynamic and to historical analysis. Thirdly, because a pure market economy is no longer the norm against which all other economies are to be measured and as the institutional architecture in each economy plays an important role in the dynamics of the whole system, there is more than one single best system. According to this view, there is no easy choice between alternative institutional architectures, since each is a result of complex historical processes.

Fourth, in adopting this methodology, the recent and contemporary trajectory of the Japanese economy needs to be interpreted within a long-term historical perspective. One of the authors states that a key objective of regulation theory is to reconcile economic theory and history and the regulationist approach can provide a clearer understanding of the crisis. Crises can occur if the institutional forms that were tuned to respond to a certain set of expected exogenous shocks turn out to be unable to cope with an unexpected exogenous shock. Crises could also occur when "the very functioning of the existing regulation mode triggers economic, financial and social evolutions that are destabilizing the coherence of the institutional forms which are at the core of this regulation mode". One of the main theses of the book is that Japan has entered into a crisis of fundamental import.

The book consists of three parts. The first part diagnoses the core institutions governing the Japanese economy since the Second World War. The chapters describe a "companyist" compromise which characterizes the Japanese economy and focus on the institutional complementarity between the two major institutional forms: the wage-labour nexus and the monetary and financial regime. This institutional analysis is complemented by a macroeconomic analysis of the growth and accumulation regimes. The second part is devoted to an analysis of the major structural transformations that have taken place in Japanese institutional arrangements in recent years. It shows how the relationship between the financial sector and employment policy, which was complementary during the golden age of rapid economic growth, came to be associated with the asset inflation of the 1980s triggered by the financial liberalization. This section investigates the key role played by the financial system in destabilizing corporate governance and more generally the regulation mode itself.

The third part analyses the nature of the ongoing crisis and attempts to diagnose possible future restructuring of the regulation mode.

According to the regulationist interpretation, many problems that Japan faces today originated in the 1970s, when growth slowed down after the oil shocks and internationalization of the Japanese economy destabilized the financial regime. The erosion of the coherence of the financial system (represented by the bank-based structure of corporate finance and governance led by the main banks and strong intervention and regulation by financial authorities) triggered a series of institutional transformations. Such transformations then affected the inner dynamism of the growth regime. The book concludes: "the Japanese economy apparently has entered into a new phase, with major disequilibria in the adjustments of economic activity, a clear destabilization of most institutional forms and long-lasting structural incompatibilities between these forms".

For economists trained in the neoclassical tradition, the use of words such as "regime" and "compromise" brings up an immediate sense of suspicion and aversion. However, at the same time, the benefit of a historical perspective and the institutional analysis cannot be denied in fully understanding the unfolding economic, political and social reality. Therefore, going past the initial misgivings we move toward "fuzzy" institutional analysis, and following through the chapters, readers will be amply rewarded. Most of the chapters are clearly written. Many chapters contain helpful summary diagrams and tables that distil the key ideas and arguments into manageable syntheses. By the time the concluding chapter is reached, readers are, by and large, convinced of the authors' representation of the organization and workings of the key institutions in the Japanese economy, and its trajectory from a well-functioning, mutually complementary system to destabilization and eventually into a deepening structural crisis. The book brings clarity to an understanding of the evolution of Japanese-style capitalism since the Second World War. Its conclusion confirms the sense that Japan is currently facing a historical challenge of the third major reconfiguration of its economic/political/social system in modern times, which parallels that of the Meiji Restoration and the building of the post-war economic system, rather than a temporary economic slowdown.

But, then, where is Japan going from here? The book provides three possible scenarios for the coming decades. In the first scenario, the basic institutional forms are only marginally redesigned, preserving most of their "Japaneseness". This outcome, however, requires highly optimistic assumptions, such as a soft way out of the Japanese financial crisis, dynamic world trade, a quick recovery of the Asian economies and continuous prosperity of North America and/or the European Union. Many of these assumptions have already turned out not to be the case.

In the second scenario, a major crisis spurs the adoption of typical market-led capitalism. The failure of the so-called Asian development model or the Japanese model could facilitate a direct importation of Anglo-Saxon-style market-led capitalism. At the time of the book's publication, the recent slowdown of the United States economy had not yet started. The question regarding the long-term viability of the regulation mode of the new economy which brought the unprecedented long boom in America during the 1990s has already been answered negatively. Furthermore, as the book correctly speculates, it is very unlikely that the public authority in Japan could manufacture such a dramatic revolution, completely redesigning the basic compromise between managers and wage-earners, and building a fully fledged welfare system to protect against the unprecedented rise in unemployment that would result from the adoption of the American model.

The book predicts that the most likely third scenario is a hybrid of these two. On the one hand, the post-Second World War system has reached its limits, producing poorer and poorer results. On the other hand, a pure market-led system cannot be grafted directly onto Japanese society. Thus, "the process of modernization will take a specific pattern, reiterating an adoption/adaption (adaptation) strategy that has been observed since the Meiji era. In other words, the internal and external pressures and opportunities will induce a hybridization process not only of organizations, but of economic and financial institutions". What exactly would be the outcome of such hybridization would depend upon institutional compromises among managers, politicians, unionists and citizens.

The editors of the book encouragingly proclaim that "this is a message of hope for the Japanese people who may find a way of modernizing, once more, without losing either social cohesion or historical distinctiveness" (notice the word "may"). Readers may also believe in this hopeful outcome. In the end, however, there are no guidelines as to how that process of trial and error may unfold. This seems to be the limitation of historical/institutional analysis. Alas, it is not a tool for predicting the future. Granting this limitation, the book is highly recommended, not only for those who are interested in Japan, but also for all those who are open to learning from a well-argued analysis that can enrich and broaden an understanding of economic reality in different settings. As to Japan's future, curiosity may have to be satisfied with the thought that we are witnesses to rare moments in the country's history.

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* The views expressed in this review are those of the reviewer and do not necessarily reflect those of the United Nations.